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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 202

THE JOCKEY CLUB, PETITIONER

v.

THE UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. 19-25) is reported at 137 F. Supp. 419.

JURISDICTION

The judgment of the Court of Claims dismissing the petition (Pet. 50) was filed on January 31, 1956, and a motion for rehearing was denied on April 3, 1956 (Pet. 51). The petition for a writ of certiorari was filed on June 26, 1956. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1255(1).

QUESTION PRESENTED

Whether petitioner is entitled to exemption from tax as a business league under Section 101(7) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.
>
> The following organizations shall be exempt from taxation under this chapter—
>
> * * * * *
>
> (7) Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual * * *.
>
> (26 U.S.C. 1952 ed., Sec. 101.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> Sec. 29.101(7)-1. *Business leagues, chambers of commerce, real estate boards, and boards of trade.* —A business league is an association of persons having some common business interests, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is organization of the same general class as a chamber of commerce or board of trade. Thus its activities should be directed to the improvement of business con-

ditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. * * *

STATEMENT

The petitioner filed suit in the Court of Claims seeking a refund of income taxes paid during the years 1945 through 1950, except 1947 when it had no net income, on the ground that it was exempt from tax under Section 101(7) of the Internal Revenue Code of 1939. (Pet. 19-20.) The Court of Claims denied the claimed exemption status (Pet. 23-25) and dismissed the petition (Pet. 50).

The detailed findings of fact of the Court of Claims (Pet. 25-50) may be summarized as follows:

Petitioner, the Jockey Club, was organized under New York legislation in 1894 after a group of owners and breeders of thoroughbred race horses in the United States adopted a resolution proposing the formation of such a club of 50 members to encourage the development of the thoroughbred horse and to establish racing on a basis commanding public confidence and interest. They contemplated that the organization would establish a firm authority over all racing which might come within its control, punish offenders against accepted racing rules, protect the interest of the public in racing, and dispense justice in respect of all questions pertaining to racing which might affect the welfare of the associations racing under the rules of the proposed

organization. The Club's particular objects and purposes, as set forth in its certificate of incorporation, are "the investigating, ascertaining and keeping a record of the pedigree of horses, and of instituting, maintaining, controlling and publishing a *Stud Book* or Book of Registry of horses in the United States of America and Canada; and of promoting and holding exhibitions of such horses *and generally for the purpose of improving the breed thereof.*" (Pet. 25-26.)

The Club has no capital stock, corporate shares or certificates of ownership of any kind. Its by-laws provide for a membership of 50 persons who shall be interested in the breeding and racing of horses. Membership is by election and is not transferable. The initiation fee per member is $200 and the annual subscription $200 a year per member. During the years 1945 through 1950 about 35 or 36 of the 50 members owned thoroughbred breeding farms, and all, with the possible exception of one, owned or raced thoroughbred horses. (Pet. 27.)

The Club's affairs are managed by a board of nine stewards which corresponds to the board of directors of a business. The stewards receive no compensation. The Club has the usual corporate officers, of whom only the executive secretary receives a salary. He is not a steward or member of the Club. There are 22 employees. (Pet. 27-30.)

The Club has promulgated rules of racing which are accepted as the basic rules and have been adopted wherever racing is conducted in the United States. They deal with every feature of the arrangements necessary for the conduct of racing. Among other things, the Club passes upon the applications of owners, trainers and jockeys for licenses, investigates their charac-

ter and responsibility, and in proper cases takes disciplinary measures against them which are recognized in all jurisdictions where racing takes place, both in the United States and abroad. (Pet. 31-34.)

Since 1897 the Club has kept and published the American Stud Book, the only source from which breeders can learn the blood lines of every thoroughbred horse registered in the United States. The book is indispensable to the breeding and racing of thoroughbred horses in the United States. The Club also publishes monthly and distributes its Racing Calendar, which contains information only available therein and is important to the businesses of breeding and racing. On its records the Club did not allocate its overhead expenses attributable to the two publications, but it is reasonably probable that the Club realized no profit on the sale of either the American Stud Book or the Racing Calendar. (Pet. 35-36.)

The Club instituted and conducts, without charge, a school for training and improving the quality of officials to officiate at thoroughbred race meetings throughout the United States. Such officials are in much demand. (Pet. 36.)

The Club maintains at its expense an experimental breeding station at Avon, New York. Stallions, some of which belong to members of the Club, are kept at the breeding farm. Stallion fees are charged but the farm does not make a profit. (Pet. 30, 36-37.)

During the taxable years the Club's purpose was to promote the common interest in breeding and racing thoroughbred horses and the Club's activities were directed toward that purpose. The members of the Club also had a common interest in the breeding and racing of thoroughbred horses. (Pet. 39.)

The breeding and racing of thoroughbred horses are businesses in which millions of dollars are invested and are conducted for the purpose of making a profit. The activities of the Club are indispensable to these businesses, including the businesses of its members engaged in breeding or racing or both. The activities of the Club have had an important effect in increasing the value of thoroughbred race horses for racing and breeding purposes. (Pet. 37-39.)

The Club had a net income of more than $60,000 in four of the five taxable years involved. Except for some payments to charities, the Club's income is used or held for its corporate purposes. Its surplus, which had been accumulated since 1894, was $730,243.78 at the end of 1950. The total receipts from dues and from income from investments was $767,746.85, of which $426,700 came from dues and $341,046.85 was income from investments. The Club has in contemplation new activities which would require large expenditures. (Pet. 41-45.)

During the taxable years the Club derived income and incurred expenses which are shown in detail at Pet. 42-43. The major portion of the income was derived from the rendition of services, of which compensation designated as "racing commissions" was the largest single item. Such compensation, which totalled between over $58,000 and over $67,000 in the taxable years, was paid to the Club for services rendered to five New York race tracks and one race track in Delaware and was composed of a per diem fee of $300 a racing day for, among other things, the general supervision of race meetings, the investigation of persons engaged in racing, policing the grounds and some legal services. Such services were performed pursuant

to letter contracts. Income was also derived by the Club from charges made for numerous other services, including the licensing of jockeys, trainers, owners and employees. (Pet. 40-42.)

The Court of Claims held that the Club's business and service activities precluded it from exempt status under Code Section 101(7) and the Treasury Regulation thereunder. (Pet. 23-25.)

ARGUMENT

As grounds for certiorari, the petitioner asserts that the decision below is not supported by proper findings of fact (Pet. 14-16), that it conflicts with other decisions, including decisions of this Court (Pet. 8-14), and involves an important question which should be settled by this Court (Pet. 16-17). These assertions are erroneous.

1. Section 29.101(7)-1 of Treasury Regulation 111, *supra*, pp. 2-3, stating a long-standing interpretation,[1] declares that exemption as a business league is unavailable where the claimant organization (1) has the purpose of engaging "in a regular business of a kind ordinarily carried on for profit" or (2) directs its activities to "the performance of particular services for individual persons." Petitioner does not question the validity of these plainly proper tests under 1939 Code Section 101(7), but asserts that the Court of Claims made no valid findings to support its agreement with the Commissioner that the exemption should be denied. Contrary to this assertion, the findings fully and

[1] See to the same effect as this Regulation under the 1939 Code Article 101(7)-1 of Treasury Regulation 86, promulgated under the Revenue Act of 1934. The regulations before that were substantially the same. See, *e.g.*, Article 518 of Treasury Regulations 45 (1920 ed.).

explicitly support denial of the exemption on each of the two alternative grounds.

The findings show that petitioner's principal activities were those of a service organization for individuals (see Pet. 27-44), including the publication of the Stud Book and the Racing Calendar. These latter enterprises, as the court stated (Pet. 24), would certainly have been undertaken by someone as a business activity for profit were it not for the fact that petitioner already covered the field. Petitioner is clearly mistaken, we think, in its suggestion (Pet. 14) that its exclusive position in carrying on these particular profitable ventures precludes a finding that they constituted "a regular business of a kind ordinarily carried on for profit." The Court of Claims correctly held (Pet. 24) that, as a matter of commonly known fact, petitioner's services were substantially like other trade publication and trade service enterprises "ordinarily carried on for profit."

2. While the decisions on which petitioner relies for conflicts hold that an "incidental" service or business activity does not preclude exemption, the asserted conflicts are based on the premise that "incidental" means "related" (see Pet. 11-14), whereas the word "incidental" has been used in the decisions in contrast to "principal." Thus, in *Trinidad* v. *Sagrada Orden*, 263 U. S. 578, which involved subsection (6) rather than subsection (7) of the exemption statute, it was held that a concededly religious corporation was not to be denied exemption because of "limited trading, if it can be called such" (p. 581) which was not done for profit, did "not amount to engaging in trade in any proper sense of the term" (p. 582), and involved articles "for strictly religious use" and for "uses which are purely inciden-

tal to the work which the plaintiff is carrying on" (p. 582). The Court of Appeals' decisions cited by taxpayer (*Commissioner* v. *Chicago Graphic Arts F.*, 128 F. 2d 424 (C.A. 7th); *Crooks* v. *Kansas City Hay Dealers' Ass'n*, 37 F. 2d 83 (C.A. 8th); *Retailers Credit Ass'n* v. *Commissioner*, 90 F. 2d 47 (C.A. 9th)) apply the *Sagrada Orden* decision to the statute and regulation relating to business leagues. In the *Chicago Graphic Arts* and *Kansas City Hay Dealers' Ass'n* cases the service activities held to be "incidental" were related, minor activities which resulted in only small profits. In *Retailers Credit Ass'n* a distinction was specifically drawn between "incidental" and "principal," and exemption was denied on the ground that the service activity was in fact "a principal or main purpose" (p. 52). The distinction is one which has also been drawn in other cases. See *Automotive Electric Ass'n* v. *Commissioner*, 168 F. 2d 366 (C.A. 6th); *General Contractors' Ass'n* v. *United States*, 202 F. 2d 633 (C.A. 7th). See, also, *Underwriters' Laboratories* v. *Commissioner*, 135 F. 2d 371 (C. A. 7th), where exemption was denied because the business or service activity was conducted for profit.

In the present case, where petitioner performed many services for individuals, for profit both to petitioner and to the individuals, decision rests on the conclusion of the court below (Pet. 24), amply supported by the facts, that the performance of such services was one of petitioner's "principal" activities and sources of income. The performance of the services was obviously also one of petitioner's principal purposes. There is no conflict between the decision below and the cited cases.

3. Petitioner contends (Pet. 16-17) that this case is important as a vehicle for determining whether the test

for exemption under Section 101(7) should be "the destination of the income," a criterion applied in some decisions under *subsection (6)* of 101, or "the source of the income * * *." But this difference, which we have urged to present no basis for certiorari now even in cases which fairly present it under 101(6), is still more clearly unworthy of review in this case under 101(7).

There is an acknowledged conflict as to whether an organization engaged in a business for profit is entitled to the charitable or educational exemption under Section 101(6) simply by reason of the ultimate destination of its income (cf. *John Danz Charitable Tr.* v. *Commissioner*, 231 F. 2d 673 (C.A. 9th), pending on petition for certiorari, No. 145, this Term, and *United States* v. *Community Services*, 189 F. 2d 421 (C.A. 4th), certiorari denied, 342 U. S. 932, with *Sico Co.* v. *United States*, 102 F. Supp. 197 (C. Cls.), and *C. F. Mueller Co.* v. *Commissioner*, 190 F. 2d 120 (C.A. 3d)). However, as we show in our brief in opposition to certiorari in *John Danz Charitable Tr.* v. *Commissioner*, *supra*, that question is now largely academic. And the present case does not even involve any such question. Here subsection (7), rather than subsection (6), is involved and the question is with respect to exemption as a "business league," a term which, under Section 29.101(7)-1 of Treasury Regulations 111, covers only an organization directed to the improvement of business conditions which does *not* perform particular services for individuals. In other words, it is the type of business activity which determines whether the organization is exempt. As applied by the courts, the regulation precludes exemption when the organization performs services for individuals except when such activities are purely in-

cidental, not just related, to a purpose to improve business conditions. Thus, the question which petitioner asserts to be important and asks this Court to settle is one which is already settled by a regulation having the force and effect of law.[2]

Sections 301 and 302 of the Revenue Act of 1950, c. 994, 64 Stat. 906, relied upon by taxpayer (Pet. 11-13), have no particular bearing on this case. Sections 421 and 422 of the 1939 Code, as amended by Section 301 of the 1950 Act, imposed a tax on the unrelated net income of *exempt* corporations for taxable years beginning after December 31, 1950. Section 302(a) of the 1950 Act provided that for taxable years beginning prior to January 1, 1951, no organization should be denied exemption under Section 101(7) (and certain other paragraphs of Section 101) on the ground that it was carrying on a business for profit if the income of such trade or business would not be taxable as unrelated business income under the 1950 amendments to Sections 421 and 422 of the Code. S. Rep. No. 2375, 81st Cong., 2d Sess., p. 118 (1950-2 Cum. Bull. 483, 567), stated that this provision applied only where a denial of exemption might be made on the ground that the organization was carrying on a business for profit and "nothing therein limits the denial of exemption for failure to meet other requirements of section 101." As the Court of Claims held, the taxpayer here does not meet the requirement of Section 101(7), as implemented by Section 29.101(7)-1 of Treasury Regula-

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[2] Since the test of exemption under Section 101(7) clearly excludes destination of income as a basis for exemption, petitioner is incorrect in asserting (Pet. 10) that the decision below is in conflict with the decision of the same court in *Sico Co.* v. *United States*, *supra*, which involved Section 101(6), not Section 101(7).

tions 111, that its activities be directed to the improvement of business conditions in one or more lines of business "as distinguished from the performance of particular services for individual persons." Thus, the problems which might arise under Sections 301 and 302 are never reached in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JULY, 1956.

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